Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI		X		
2	DDCI		X		
3	EXDIR				
4	D/ICS				
5	DDI				
6	DDA		X		
7	DDO				
8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt		X		
13	D/Pers				
14	D/OLL				
15	D/PAO				
16	SA/IA				
17	AO/DCI				
18	C/IPD/OIS				
19	~~NIO/ECON~~		X		
20					
21					
22					
	SUSPENSE		Date		

Remarks

STAT

Executive Secretary

19 November 1984

Date

3637 (10-81)

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

THE WHITE HOUSE
WASHINGTON

Executive Registry
84 - 9613/1
84-9613

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 11/16/84 **Number:** -------- **Due By:** ---------

Subject: Cabinet Council on Economic Affairs Minutes:

October 16, 25, 30 and November 8

	Action	FYI
ALL CABINET MEMBERS	☐	☑
Vice President	☐	☐
State	☐	☐
Treasury	☐	☐
Defense	☐	☐
Attorney General	☐	☐
Interior	☐	☐
Agriculture	☐	☐
Commerce	☐	☐
Labor	☐	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☐	☐
Energy	☐	☐
Education	☐	☐
Counsellor	☐	☐
OMB	☐	☐
CIA	☐	☐
UN	☐	☐
USTR	☐	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☐	☑
CEQ	☐	☐
OSTP	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
Baker	☐	☑
Deaver	☐	☑
Darman *(For WH Staffing)*	☑	☐
Mc Farlane	☐	☑
Svahn	☐	☑
Chapman	☐	☑
_____	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
Executive Secretary for:		
CCCT	☐	☑
CCEA	☐	☑
CCFA	☐	☑
CCHR	☐	☑
CCLP	☐	☑
CCMA	☐	☑
CCNRE	☐	☑

REMARKS:

Attached for your information are the minutes of the following CCEA Planning Meetings:

October 16
October 25
October 30
November 8

DCI EXEC REG

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823 (White House)

☐ Don Clarey ☑ Tom Gibson ☐ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs
456-2800 (Room 128, OEOB)

L-300B

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

October 16, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Baldrige, Brock, Porter, Wright, Niskanen, Burnley, Ford, Knapp, Ballentine, Cicconi, Gibson, Hawley, Herbolsheimer, McCormack, McMinn, Platt, and Li, Ms. McLaughlin, and Ms. Risque.

1. Government Spending and the Private Economy

Mr. Ballentine presented a paper examining trends in the composition of government spending and its effects on the private economy. Federal spending consists of two broad components: purchases of goods and services and transfer payments. Only government purchases of goods and services directly crowd out private spending. While government transfer payments do not directly crowd out private spending, because they only transfer purchasing power from one group to another, transfer payments indirectly crowd out private spending through supply-side effects of taxes and transfer programs. Various studies of the indirect crowding out of tax finance suggest that there is about $1.25 to $1.50 less of private GNP for every $1.00 raised by the government in taxes.

The Council discussed the effects of the budget deficit on the economy. It noted that the deficit has not appeared to crowd out business fixed investment. However, financing of the deficit has significant distortionary effects on incentives to save and work. The Council discussed the differential impacts of financing the deficit through taxation or borrowing.

The Chairman Pro Tempore requested that an interagency working group comprising representatives from the Treasury, Office of Management and Budget, Council of Economic Advisers, and Commerce prepare a paper evaluating the effect on the economy of different means of financing the budget deficit and further analyzing the effects of government spending on the economy.

2. Legislative Update

Mr. Brock reviewed the provisions in the trade bill recently passed by the Congress. On the whole, the bill includes elements the Administration sought or that are acceptable to

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

us. There are, however, two troubling provisions. First, the bill included a sense of the Congress resolution that the President should negotiate voluntary restraint agreements on copper production. Second, the bill requires the executive branch to monitor individual steel company compliance with reinvestment requirements, which would be difficult to do and could lead to court challenges. The Council noted that Mr. Brock was successful in deleting numerous protectionist provisions in conference and congratulated him on his efforts.

Secretary Baldrige reviewed various developments regarding the Export Administration Act that was not passed by the Congress. Difficult provisions included import controls and COCOM licensing.

Secretary Regan reviewed developments on financial institution legislation. The failure of the Congress to pass legislation closing the nonbank bank loophole means that the Comptroller of the Currency will have to start processing nonbank bank applications.

In addition, Mr. Regan noted that because the Senate delayed passage of the debt ceiling legislation, the Treasury will have to reschedule debt in four weeks that it had planned to reschedule over seven weeks. The delay is expected to result in an additional $1 billion cost to taxpayers over the life of the rescheduled debt.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

October 25, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Ford, Porter, Wright, Niskanen, Burnley, Jones, Cicconi, Gibson, Hawley, Healey, McCormack, McMinn, Platt, and Li, Ms. McLaughlin, Ms. Risque, and Ms. Horner.

1. Recent Trends in the Economic Pursuits and Status of Women

Mr. Jones presented a review of the impact of demographic shifts on the economic status of women. Today more women are in the labor force than ever before. In particular, the proportion of working mothers with young children is increasing. Women are more likely to work full-time during the entire year. More women are enrolling in higher education. For example, the proportion of law degrees awarded to women increased from 5 percent in 1970 to 30 percent in 1980.

In the aggregate, there are significant wage differences between men and women. For year-round, full-time workers, the median income for men in 1983 was $22,000, while that for women was $14,480. After adjusting for factors such as occupation, experience, and continuous employment, the differences are significantly less.

Mr. Jones noted in particular the disparity in the economic status of households headed by females and that of other households. The poverty rate of households headed by black females was over 50 percent in 1983, while that of other black households was under 20 percent. The poverty rate for households headed by white females was slightly under 30 percent, while that for other white households was under 10 percent. In addition, a substantially higher proportion of households headed by females than other households receive transfer payments from programs such as Aid to Families with Dependent Children, food stamps, public housing, and medicaid.

Mr. Niskanen presented data regarding the wage gap between men and women. He pointed out that when various factors are adjusted, the wage differences between men and women narrow

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

significantly. For example, the female/male ratio of weekly earnings for full-time workers is 96 percent for the 16-19 age group, while that ratio is 67 percent for the 55-64 age group. Reasons that could explain why women earn less than men include: 1) women classified as working full-time work fewer hours than men classified as working full-time (less overtime and moonlighting); 2) older women have less labor market experience and less tenure in their current job than men; and 3) women tend to work in occupations that pay less than those in which men work.

An unexplained portion of the wage gap does not necessarily imply discrimination since it could be due to other variables. Conversely, full explanation of the wage gap does not rule out discrimination. Mr. Niskanen noted that the most important role for government is to ensure that men and women have equal access to acquiring skills and that there are no artificial barriers to entry into occupations for men and women.

The Council discussed private and public programs for child care. It noted the difficult problems entailing substantial social and economic costs faced by families with female headed households.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

October 30, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Brock, Ford, Niskanen, Darman, Porter, Wright, Lyng, Brown, Burnley, Boggs, Poole, Sprinkel, Ballentine, Cicconi, Fitzwater, Gibson, Hawley, Herbolsheimer, Knapp, McMinn, Platt, and Li, and Ms. McLaughlin.

1. Financial Market Developments

Mr. Poole presented a paper discussing real interest rates and reviewing the reasons why they have been high in recent years. It is important to distinguish between the ex ante real interest rate, which is relevant for investment and savings decisions, and the ex post real interest rate, which is relevant for measuring investment outcomes. The five year average ex ante real interest rate for 52-week Treasury bills has increased from 0.52 in 1975-1979 to 4.34 in 1980-1984. These rates have been at a level for a long enough period that they cannot be due to monetary or random factors.

While the federal budget deficit has reduced somewhat the supply of funds in the credit markets, the increase in the demand for funds as a result of increased investment has played a more important role in raising the real interest rate. Business fixed investment and inventories have experienced unusually strong growth, while other sources of investment have expanded at a healthy pace. This increased investment has resulted from a reduction in excess capacity, rising productivity, a more stable regulatory environment, major reductions in the tax rate on earnings from new business investment, and the decline in inflation.

The Council discussed the different impacts on investment of government purchases of goods and services and government transfer payments. It also discussed the impact of the 1981 business tax rate reductions on investment.

Mr. Ballentine presented a paper reviewing international capital flows. While traditional analysis holds that shifts in the current account determine the value of a currency, recent experience suggests that net capital flows are now the determining factor. There are both increased gross

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

inflows of foreign investment into the U.S. and decreased gross outflows of U.S. investment abroad because U.S. and foreign investors often face the same investment opportunities. However, from a long-term perspective, the gross inflows of capital in 1981-1984 were high and the gross outflows of capital in 1983 were low relative to their levels in the late 1970's. It appears that the very large gross inflows of foreign investment have played a more important role than declining gross outflows for the change in net capital flows.

The Council discussed the reasons for the increasing inflow of foreign capital into the U.S. It discussed whether capital flowing to the U.S. from Europe is from the region initially or transferred from other regions.

Mr. Sprinkel presented a paper reviewing recent developments in the economy, interest rates, and monetary policy. Short-term interest rates have declined in recent months. The prime rate has been cut several times, the 90-day Treasury bill rate has declined by about 150 basis points since August, and the Federal funds rate has fallen substantially. Long-term interest rates have fallen as well by about 120-180 basis points from their June peaks.

Mr. Sprinkel attributed this decline to four principal developments:

1. Private credit demands have declined;

2. The deceleration in the money growth rate has eased inflationary expectations;

3. The market has apparently eased its concerns about the instability of the banking sector; and

4. The substantial decline in the Federal funds rate has encouraged the view that the Federal Reserve has adopted an easier policy stance.

Mr. Sprinkel argued that while we obviously welcome the favorable developments in interest rates, there are reasons to remain cautious. First, the Federal Reserve should be careful to avoid an unnecessarily prolonged deceleration in money growth. Second, the Federal Reserve should allow

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

market forces to play a greater role in determining the Federal funds rate. Finally, it is important to focus on the long-term trend of money growth, which is more important than the short-term trend in determining the inflation rate.

The Council discussed the recent growth of money supply and the target ranges for money growth.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

November 8, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Block, Baldrige, Brock, Ford, Niskanen, Porter, Wright, Wallis, Burnley, Ballentine, Gibson, Haraf, Hawley, Johnson, Knapp, Platt, and Li.

1. The 1985 Economic Report

Mr. Niskanen presented a summary outline of the 1985 Economic Report. The Council of Economic Advisers has already begun work on the Report and expects to complete first drafts by Thanksgiving.

The first chapter will review the economic record of the last four years, noting that the economy has moved from a period of high inflation and low productivity to one of low inflation and higher productivity. It will also present the economic outlook for 1985-1990.

The second chapter will review the relationships between the economy and the Federal budget. It will also discuss various budget process issues, such as capital budgeting, accrual vs. cash budgets, the congressional budget process, line-item veto authority, and the balanced budget constitutional amendment.

The third chapter will focus on international economic policy. Although it will address international financial issues, it will focus primarily on U.S. trade policy. There will be discussion of the need and prospects for a new round of trade negotiations.

The fourth chapter will address the economics of health care. It will analyze the demand for and supply of medical care and the relationship between health status and medical care. It will also analyze the role that government has played in increasing the demand for and price of health care.

The fifth chapter will review the economic status of the elderly. It will analyze the demographic trends, the sources of financial support for the elderly, and major public policies affecting the economic status of the elderly.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

The last chapter will address the organization of American industry. It will review recent changes in business organization, corporate governance and control, and government policies affecting organization, such as antitrust laws, securities regulation, and tax policy.

The Council discussed whether the Report might devote specific chapters to the current employment situation or antitrust law. It noted that the employment situation should improve further because of demographic shifts, for example, the decline in the number of teenagers. The Council suggested that the chapter addressing international economic policy note how U.S. economic policy has served as a model for improving the climate of economic policy abroad.

2. The Determinants of Total Federal Expenditures

Mr. Niskanen also presented a paper exploring the primary conditions affecting total Federal expenditures from World War II through 1980, the effect of the levels of prior debt or current tax receipts on total Federal expenditures, and the degree to which determinants of total Federal expenditures from World War II through 1980 explain the level of expenditures since 1980.

After running several regressions, Mr. Niskanen concluded that over the time period of 1948 to 1980:

- An increase in relative GNP per capita strongly increased the Federal expenditure share of GNP.
- An increase in the unemployment rate by 1 percentage point increased the Federal expenditure share of GNP by about 0.8 percentage points.
- Changes in the number of armed services personnel overseas accounted for a substantial proportion of the var ance in total Federal expenditures.

He also concluded that considering the levels of prior debt and the current level of tax receipts does not significantly increase the explanatory power of the model and that these variables are not significant statistically. However, the results suggest that an increase in the level of prior debt may have a constraining effect on future Federal expenditures over the short-term. Finally, he concluded that the model based on data from 1948 to 1980 relatively accurately predicts total Federal expenditures since 1980.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI		X		
2	DDCI		X		
3	EXDIR				
4	D/ICS				
5	DDI				
6	DDA		X		
7	DDO				
8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/Pers		X		
14	D/OLL				
15	D/PAO				
16	SA/IA				
17	AO/DCI				
18	C/IPD/OIS				
19	~~NIO/ECON~~		X		
20					
21					
22					
	SUSPENSE		Date		

Remarks

STAT

Executive Secretary

19 November 1984

Date

3637 (10-81)

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:			ACTION	INFO	DATE	INITIAL
	1	DCI				
	2	DDCI				
	3	EXDIR				
	4	D/ICS				
	5	DDI				
	6	DDA		X		
	7	DDO				
	8	DDS&T				
	9	Chm/NIC				
	10	GC				
	11	IG				
	12	Compt				
	13	D/Pers		X		
	14	D/OLL				
	15	D/PAO				
	16	SA/IA				
	17	AO/DCI				
	18	C/IPD/OIS				
	19	[illegible]		X		
	20					
	21					
	22					
		SUSPENSE _____ Date				

Remarks

L-DP

Executive Secretary

23 Oct 84

Date

3637 (10-81)

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

THE WHITE HOUSE
WASHINGTON

Executive Registry
84- 9613

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 10/22/84 **Number:** 169086CA **Due By:** _____

Subject: Cabinet Council on Economic Affairs Planning Meeting - October 25, 1984

8:45 A.M. - Roosevelt Room TOPICS: Economic Pursuits & Status of Women
Leveraged Buyouts

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☑	☐
Attorney General	☐	☑
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☑	☐
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
Baker	☑	☐
Deaver	☐	☑
Darman *(For WH Staffing)*	☑	☐
Mc Farlane	☐	☑
Svahn	☑	☐
Chapman	☐	☑
_____	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
Executive Secretary for:		
CCCT	☐	☐
CCEA	☑	☐
CCFA	☐	☐
CCHR	☐	☐
CCLP	☐	☐
CCMA	☐	☐
CCNRE	☐	☐

REMARKS:

The Cabinet Council on Economic Affairs will meet on Thursday, October 25, 1984, at 8:45 A.M. in the Roosevelt Room.

The agenda and background papers are attached.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823 (White House)

☐ Don Clarey ☑ Tom Gibson ☐ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs
456-2800 (Room 128, OEOB)

DCI EXEC REG

L-300B

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

THE WHITE HOUSE

WASHINGTON

October 18, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the October 25 Meeting

The agenda and papers for the October 25 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The first agenda item concerns recent trends in the economic pursuits and status of women. A report, prepared by Sidney Jones, Chairman of the Working Group on the Economic Impact of Demographic Changes, on this subject is attached.

The second agenda item is a review of recent leveraged buyout transactions. At the October 16 meeting of the Cabinet Council the increasing debt leverage in the U.S. economy was noted, especially with regard to leveraged buyouts. A paper from Thomas Healey, Assistant Secretary of the Treasury for Domestic Finance, assessing the current situation and potential concerns with respect to leveraged buyouts is attached.

Attachments

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

October 25, 1984

8:45 a.m.

Roosevelt Room

AGENDA

1. Recent Trends in the Economic Pursuits and Status of Women (CM # 403)

2. Leveraged Buyouts (CM # 497)

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for Economic Affairs
Washington, D.C. 20230

CM #403

September 26, 1984

MEMORANDUM FOR: The Cabinet Council on Economic Affairs

FROM: Sidney L. Jones
Under Secretary for Economic Affairs

SUBJECT: Recent Trends in the Economic Pursuits and Status of Women

At the Council's request the Department of Commerce has undertaken a study of women in the U.S. economy. The following report summarizes the preliminary results.

The last two decades have seen striking changes in the economic status of women. More women are in the labor force than ever before; they are more likely to have continuous lifetime work experience; they are better educated; and the law mandates greater opportunity for equal employment. As a group, however, most women continue to work in traditionally female, lower-paying occupations. Women have not achieved significant average wage gains relative to men, and they still constitute a majority of the poverty population. Differences in the economic situation of men and women may be partly the result of labor market and societal discrimination, but probably also reflect women's substantial commitment to the care of the family, and in some cases the voluntary choices of women.

Women are not one large homogeneous group and the complexities of their economic status cannot be understood from sweeping generalizations based on summary statistics. The situation for older women is quite different from that of younger women. Black and Hispanic-origin women, in general, face problems that are more intense and difficult than those of many White women. Women who are well-educated tend to have more resources and smaller families than women with lower levels of educational attainment, and consequently, tend to be better off in terms of overall health, financial status, and well being.

New cohorts of women begin their economic activities in a far different situation than their grandmothers or even mothers. They are better educated and have joined the labor force in greater proportions and have better jobs. Yet the economic problems of women persist within an overall pattern of change and transition. The future course of the patterns described in this paper is uncertain and remains a challenge to American economic, political, and social systems.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

WORK EXPERIENCE

A. Labor Force Participation

In the last ten years the labor force participation rates of women increased by about 10 percentage points. Over 49 million women, 53.1 percent of adult women, were in the civilian labor force in the first quarter of 1984. The number of women with full-time, year-round jobs, 25.3 million, set a record in 1983.

Historically, Black women have had higher overall labor force participation rates than White women even when married; but now that divorce and later marriage is a more prominent factor in the lives of White women, the gap in the labor force rates of Black and White women is narrowing. The labor force rates of Spanish-origin, American Indian, Eskimo, and Aleut women are somewhat lower overall than other U.S. women.

In the last decade, the proportion of the female labor force who were never married increased. The proportion of divorced women in the labor force also increased over the last decade and three-fourths of divorced women were in the labor force in 1983.

In 1982, half the women in their early 20's had not yet married compared with only one-third in 1970. Marriage and childbirth are being delayed by many women while they establish themselves in the labor force. For example, the percent of married women 25-29 who are childless has doubled in the last 20 years. And the data on current birth expectations of women suggest that the current trend towards smaller families will continue.

Recently the Bureau of Labor Statistics issued projections in which the total civilian labor force 16 years and over is projected to be 131.4 million persons by 1995, of whom 61.4 million are projected to be women. This assumes an overall labor force participation rate of about 60 percent for women and 76 percent for men.

B. Working Mothers

The labor force participation rates of married women have increased dramatically in recent decades, and there has been a large influx into the work force of working mothers. In March 1984, three-fifths of mothers with children under 18 were in the labor force, a record 19.5 million, including 8 million with children under age six. In 1970, just 2 out of 5 mothers were in the labor force. These changes are the result of non-economic factors such as changes in the attitudes of

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

society towards working mothers and the desires of the women themselves, as well as more recent economic factors such as high inflation, recession, and unemployment of husbands.

The increased participation rates have been especially dramatic for married women (husband present) with children under the age of six: from 12 percent in 1950 to 50 percent in 1983. Such rates are highest for Black women, with two-thirds being in the labor force compared with about half of White women and two out of five Hispanic women. Women with babies under one year old have increasingly joined or rejoined the labor force. In 1977, 32 percent of such women were in the labor force; five years later 41 percent were working or seeking work. Such change indicates that more young women will have a continuous lifetime work history than is true of their older counterparts. More women will contribute to Social Security and private pension plans than before, and more will be eligible for full pension coverage in their own right. The trend toward working mothers has also increased the need for child care.

Women Who Maintain Families. The number of single-parent families has almost doubled since 1970. About one out of five families with children are now maintained by a woman. Six million women with children under 18 maintained their own families in March 1983 and two out of three were in the labor force. The period since 1970 has been marked by record numbers of divorces and women remaining unmarried; consequently, there are more women with major economic responsibilities and a need to work.

Over two out of five Black families were maintained by women in March 1983 compared with only one out of eight White families. Nearly a fourth of Spanish origin and American Indian families are maintained by women. Most of these families had children; almost half of all Black families with children are maintained by the mother only compared with 15 percent for Whites.

Women who maintain their own families generally have higher unemployment, lower average educational attainment, more children to raise on average than other women workers.

Teenage Mothers. For teenage mothers, the responsibility of a young child usually means disadvantages in terms of the opportunity to pursue education, a high probability of dissolution of any marriages that may occur before or after the birth of the child, reduced flexibility in career choices, more obstacles to occupational advancement, higher unemployment, lower average income, and less ability to accumulate assets to secure their future when they are elderly.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

C. Work Experience and Occupational Tenure

Today's working women are not casual labor market participants. Increasingly women are seeking and finding jobs which require year-round, full-time commitment. This is important to women because seniority is related to progression within an occupation and to eventual lifetime earnings.

Year-round, Full-time Work. In spite of recent increases, women do not, as a group, work year-round and full-time to the extent that men do; 46 percent of women workers were employed year-round and full-time in 1982 compared with about 62 percent of male workers. The increase in the proportion of women workers who work full-time and year-round has been most striking among women 25-54; e.g., in 1974, 48 percent worked year-round and full-time compared with 53 percent in 1982. Women who are divorced worked the most hours in 1982.

Part-time Work. In 1983, just over a fifth of White women workers 20 years and over were in the part-time labor force as was also the case in 1973; the proportion of Black women part-time workers dropped from about 17 percent in 1973 to 11 percent in 1983. The decrease in part-time work among Black women and their increase in working year-round and full time may be related to their increasing likelihood of maintaining a family without the aid of a husband.

Job Turnover. Women experience greater job turnover than men. Overall one out of nine men had 25 or more years duration in the same occupation compared with only one in twenty women. Better pay is the most frequently cited reason for changing jobs. Among women and men under age 30, however, there is little or no difference in the number of years spent with their current employer and only a 1-to-2 year difference at ages 30 to 39 compared with a 5-to-7 year difference for 40 to 64 year olds.

D. Education and Labor Force Participation

Women have made significant strides in increasing their level of education. More of them are better qualified for jobs than ever before. The college enrollment of all women 14 to 34 years old recently has been nearing that for men in contrast to a significant gap a decade earlier. White, Black, and Spanish origin women 18 to 24 years old have all experienced increasing rates of college enrollment over the last decade although for Black women, who experienced a dramatic increase during the middle 1970's, the percent enrolled seems to have levelled off.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Women still tend to choose fields of study in college that are different from men and less likely to lead to the highest paying jobs. Over the last decade there has been a substantial increase in the proportion of women receiving professional degrees but in 1978, as in the past, a higher percentage of women than men majored in education, the humanities, and the health sciences, and fewer majored in the physical sciences, engineering, and business.

E. Unemployment

The April 1984 unemployment rate of women was 7.9 percent and the rate of men 7.5 percent. During the recent recession, there was less disparity between the unemployment rates of men and women than in past decades. Part of the explanation for this narrowing lies in a change in the structure of the economy from goods production, where men predominate, to service occupations where women are concentrated and which were not as affected by the recession as was blue-collar work.

During the late 1960s the unemployment rates of wives and women who maintain their own families was similar but since the early 1970's the gap has widened. While women who maintain their own families have high labor force participation rates, they also have relatively high unemployment rates. These women tend to have lower education levels than wives and are concentrated in lower-skill, lower-paying jobs where turnover is frequent. Furthermore, in families maintained by women there is less likelihood that there will be another working family member who can cushion the effect of her higher than average unemployment.

F. Occupations in the Civilian Labor Force

Despite anecdotal evidence of female carpenters and male nurses, the overall labor market remains sharply segregated by sex. The majority of women are still in traditionally "female" occupations. Women have made progress in entering occupations predominantly held by men in the past, especially in the managerial and professional specialty occupations, but the actual number of women in higher-paying jobs is relatively small. Women are less likely to enter secretarial or clerical work now than in 1970, but they continue to be over-represented in clerical and service occupations. Of 503 separate detailed job categories, 5 of the top 10 occupations employing women are in sales and clerical work.

Among women 18 years and over who worked year round and full time in 1979, every ninth woman was a secretary. Another 5 percent were bookkeepers. Half of the year-round, full-time female workers were in just 19 occupations out of the possible

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

503 that were classified in the 1980 census and most were predominantly-female occupations. Even among highly educated women who work year-round and full-time, traditional female occupations still prevail.

A breakdown of women's employment by industry rather than occupation provides a similar picture. About 80 percent of the 16-million increase in female workers between 1973 and 1983 was concentrated in four major industry groups: professional and related services, half of which are for hospitals and elementary and secondary schools; wholesale and retail trade; finance, insurance, and real estate; and manufacturing. About 74 percent of the growth of workers in the retail trade industry is attributed to the increase in female workers.

The majority of women in the managerial and professional fields were in predominantly female jobs such as teachers and registered nurses. In the technical, sales, and administrative support occupations, a fourth of the net employment growth was in predominantly male occupations but most was in the traditional female jobs of secretary, office clerk, and cashier. Some service occupations became more integrated, -- e.g. janitors, bartenders, and guards -- but most female service workers remained in such traditionally female jobs as nursing aides, child-care workers, and waitresses.

The 1970s, however, may prove to be a pivotal decade for women in that occupational sex segregation appears to have declined. One study shows that almost half of the net employment growth of women took place in occupations in which women held less than 40 percent of the jobs in 1970. The most significant changes were in the managerial and professional speciality occupations (from 56 down to 43 percent males employed) and in the service occupations (from 68 down to 55 percent males employed). Job segregation was least changed in areas traditionally considered blue collar.

In 1981, 46 percent of entry-level accountants were women, up from 14 percent in 1970. At the experienced level, women accountants had only a 19-percent share of the employment, but this was nearly five times the 1970 share. Similarly women attorneys at the entry level had a 3 percent share in 1970 and a 28 percent share of entry level positions in 1981; the share of experienced women attorneys rose from 3 to 13 percent in the same period.

It appears that women are also increasingly creating employment for themselves. The number of self-employed women has increased five times faster than the number of self-employed men and more than three times as fast as women who received

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

wages and salaries. However, more than half the women who work for themselves are in the relatively low-paying sales and service occupations.

MONEY INCOME AND POVERTY

A. Changes in Median Money Incomes

In 1983 the median money income of women was $6,320, up 4.0 percent from 1982 in real terms; the median income of men increased at a slower rate because of the recession, up 1.6 percent to $14,630. Women who had attended college saw an increase of almost 6 percent in their median income from 1982 to 1983 compared with just 2.2 percent for men. The median income of women who worked year-round and full-time did not change much during the 1970s and in 1983 was $14,480 compared with the median for men of $22,510.

The relative gap in median income between Black and White women who work year round and full time has changed dramatically since 1955. In constant dollars, Black women had about half the income of White women in 1955, but by 1983, the gap had narrowed: median income of White women was $14,677 while that of Black women was $13,000.

B. Explanation of the Wage Gap

The literature generally shows that the earnings gap between men and women cannot be attributed to such productivity-related variables as education, general work experience, and work interruptions. There are a number of factors not accounted for which include time spent with the same employer, company training programs, and response errors in the data. Observed wage differences could partly reflect the effects of past wage discrimination. In addition, some women choose to take lower-paying jobs for personal reasons such as gaining flexibility in the hours worked or because of primary responsibility for care of the family. The fact that women take different courses of study in school from those taken by men is also a factor in different occupational patterns. There may be other factors that are less obvious. Current sample surveys do not give us enough information to isolate and quantify the amount of the earnings gap due to discrimination.

Higher education is often associated with higher incomes. White males, however, who work year-round and full-time have higher incomes at every educational level than Black men and both Black and White women who also worked year-round and full-time. Women with 4 or more years of college had median incomes only slightly higher than those of White males with 1 to 3 years of high school, and of Black men who had some college.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

C. Receipt of Alimony and Child Support

Less than 2 million of the 4 million women owed child support in 1981 were paid in full. More than 1 million received no child support payments. The average child support received was about $2,110 in 1981. Among divorced women, alimony and child support constitute about one-eighth of their total income. The mean amount of alimony received in 1981 by women was $3,000.

D. Poverty Status

Women who maintain families with no husband present and female unrelated individuals are more likely to be poor than the population as a whole. Families maintained by women had a poverty rate in 1983 of 36 percent (down from 42 percent in 1960) and accounted for nearly half of all poor families. Despite recent reductions in some transfer programs, families with low incomes had access to a greater range of government benefits than they did in the early 1970s. Benefits such as Medicaid and food stamps are not counted as income in determining poverty status but contribute significantly to the well-being of the recipients. In 1983, a fourth of families maintained by women received Aid to Families with Dependent Children and 29 percent received food stamps. One-third of the families received Medicaid and 23 percent benefitted from public housing.

Since the middle 1960s, the published poverty rate for White women maintaining families has fluctuated between 20 and 30 percent and in 1983 it was 28 percent. For Black women the rate dropped to a low of 49 percent in 1979 and in 1983 it was about 54 percent. The rates for Spanish women maintaining families have been similar to those for Black women.

Overall, women remain in a secondary economic status despite unprecedented change. Women spend more years prior to marriage supporting themselves than previously. In marriage, more contribute to the dollars coming into the household than in years past. And higher divorce rates mean more women raise children themselves, often with little or no financial help from the father.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

CM #497

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

October 19, 1984

MEMORANDUM FOR: Cabinet Council on Economic Affairs

FROM: Thomas J. Healey T-

SUBJECT: Leveraged Buyouts

There has been considerable attention paid recently to the increasing debt leverage in the U.S. economy because it is feared that the popularity of debt financing will dangerously exaggerate the economy's vulnerability to rising interest rates and economic contractions. Leveraged buyouts (LBOs) receive particular attention because they usually involve significantly more leverage than most business entities and the amounts involved in LBOs increased dramatically in 1984. (See Chart 1). Both Chairman John Shad of the Securities and Exchange Commission and Chairman Paul Volcker of the Federal Reserve Board have cautioned market participants on excessive leverage.

The impact on short-term business credit demands has been noteworthy. Short-term borrowing emerging from this recession has increased faster than in any other recovery. According to Robert Giordano of Goldman, Sachs & Co., approximately one-third of the increase in short-term credit of nonfinancial corporations in the first half of this year may be attributed to merger and acquisition activity, of which leveraged buyouts are part. This is well above previous averages. Giordano also calculates that short-term credit demands due to leveraged buyouts accounted for 17% in 1981, 44% in 1982, 65% in 1983 and 26% in the first half of 1984, of "other" credit demand (i.e., not explained by fundamental business credit demands, such as changes in inventory accumulation, trade credit extensions and bridge-financings of longer-term projects). The LBO percentage dips in 1984 only because the increase in demand due to mergers and acquisitions was so great that it dominated the "other" credit demand.

Summary of Findings

The leveraged buyout surge is significant enough to warrant careful and continuing attention. Market excesses have most likely occurred and some may eventually turn

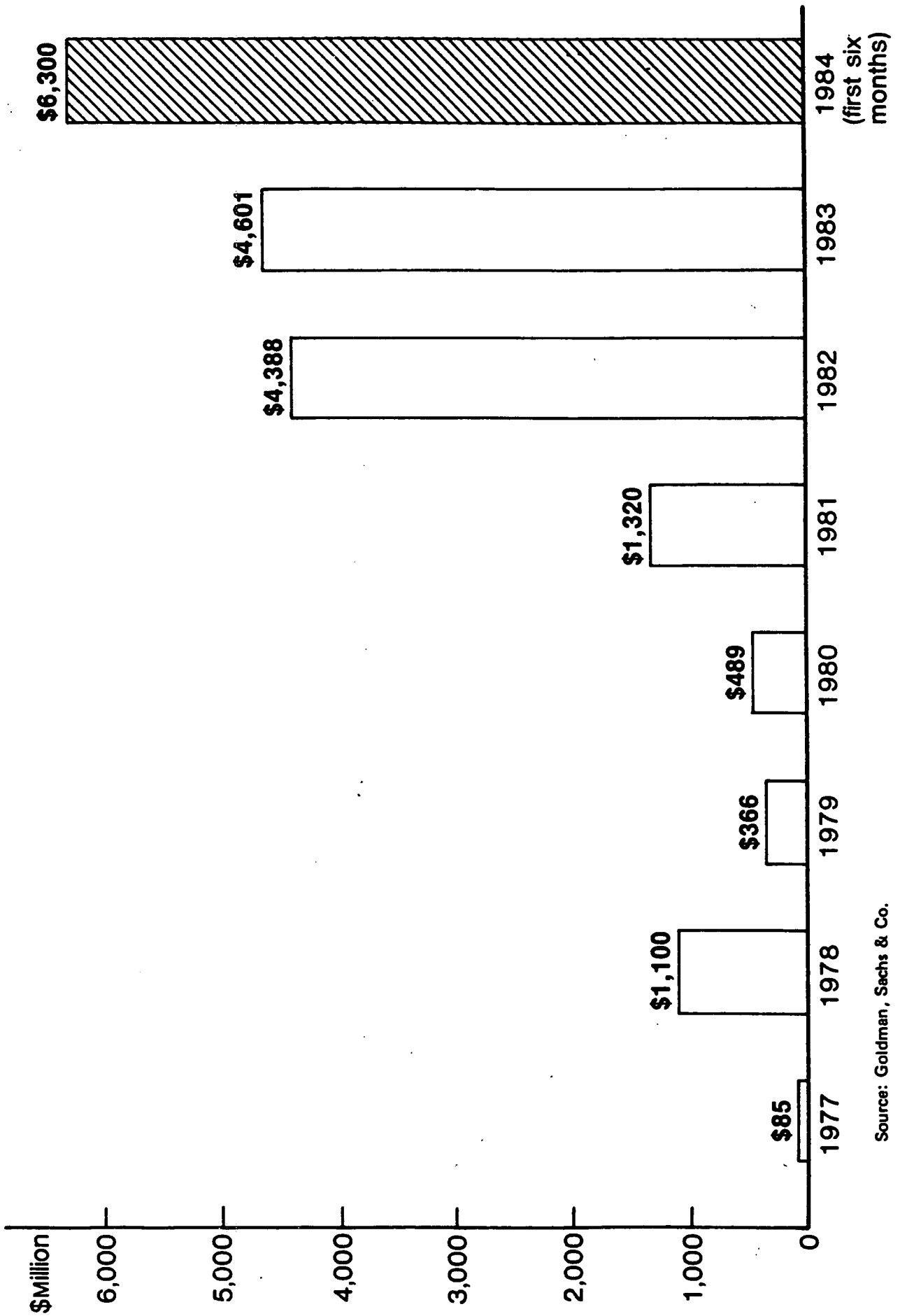
Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

CHART 1

Dollar Volume of Leveraged Buyouts Completed

1979 - present



Source: Goldman, Sachs & Co.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

into problem loans and companies. However, market forces seem to be correcting the abuses and curtailing credit. Therefore, Federal action is not warranted at this time. Should the situation become more aggravated, issues such as merger and acquisition activity in general and leverage in the economy as a whole would have to be readdressed.

Congressional activity has been minimal to date; however, Congressman Timothy Wirth (D-Colorado) has publicly expressed his intention to hold hearings in 1985. Wirth is particularly concerned about management's potential conflict of interest in setting the price of LBOs.

Brief History of LBOs

LBOs are usually characterized by three elements: 1) the sale of a business primarily for cash, 2) to a private group, 3) relying heavily on debt -- not equity --financing. In many, but not all, cases the purchasers include the existing senior management of the firm. Most typically, a public company is taken private through an LBO or a subsidiary is spun off. However, it is often difficult to distinguish LBOs from other acquisitions utilizing debt financing, so definitions vary among researchers.

What are now known as LBOs were known in past years as "bootstrap" financings because they were attempts "to pull [a company] up by the bootstraps". Debt lenders relied mainly on the liquidation value of the firm's assets in determining loan amounts rather than the company's overall financial strength, giving lenders incentive to liquidate at the first sign of trouble. Hence, a stigma was associated with bootstrap financing. Today's LBOs are distinguishable by the increased size and number of transactions, the availability of funding for entities with few leverageable assets (for example, service companies) and the lessening of the stigma.

LBOs' Sudden Prominence

The market for LBOs has skyrocketed since 1981 for four main reasons: 1) the availability of funding, 2) the surge in merger and acquisition activity, 3) changes in tax incentives and 4) the attendant publicity. Publicity on certain transactions encouraged the boom as the success of such well-publicized LBOs as Gibson Greeting Cards focused attention on potential gains. Gibson went private for $80 million and less

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

than two years later went public for $290 million. Gibson's LBO partners received over $100 million from the public offering on their $1 million equity stake in a mere 18 months.

The availability of funds more than any other factor spurred the popularity of LBOs. Initially, the size of LBOs was limited by the amount of equity and senior and subordinated debt funds available. For example, before 1979 there were few LBO deals for more than $100 million.

Equity and subordinated debt funds were previously limited to what the managers and a few venture capital firms could raise. In 1979 investors led by Prudential Insurance Company began actively participating in large LBOs above $100 million. Players in recent deals have included pension funds, insurance companies, employee stock ownership plans and mutual funds. Many of these investors participate at the "mezzanine" or subordinated debt level, usually receiving some form of equity participation as well. As a result of more investors and larger commitments by earlier investors, the funds available to LBOs increased dramatically. For example, Kohlberg, Kravis, Roberts & Co. raised $1 billion from institutional investors last winter and Dean Witter Reynolds Inc. announced a closed-end retail investment fund in June 1984.

The amount of senior debt funds available also increased as debt lenders, primarily banks and finance companies, became more aggressive in bidding on LBO deals for a variety of reasons. First, banks had funds available because much of corporate America did not need cash as it emerged from the recession and new LDC lending virtually ceased. Secondly, there was pressure on banks to increase net income as a result of weakness from other loans and continuing capital market demands for improved performance.

LBO loans carry relatively high interest rates that boost net income. For example, Prudential Insurance Co. claims that their LBO fund returns have averaged 400 basis points more than single-A rated corporate bonds bought at the same time. Thirdly, most LBO loans are floating rate which allows banks to match them against their rate sensitive liabilities.

Merger and acquisition activity, of which LBOs are but one form of transaction, has jumped in recent years

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

due to a change in corporate philosophy and favorable economic timing. In addition, some commentators argue that the rise in merger transactions encourages more LBOs allegedly because LBOs are a way either to get beyond an attacker's reach or to set a minimum price.

Corporate philosophy has focused recently on the advantages of organizations with closely-related business entities. As a result many conglomerations of unrelated companies are spinning off the business entities that do not fit their strategic goals. These entities are the fodder of mergers and acquisitions and LBOs.

The economic timing has proved favorable for divestitures and acquisitions. After living through a recession, firms generally know better what they want to sell. Furthermore, prices usually increase as the economy emerges from a recession. The higher the price for a subsidiary, the more incentive to sell unwanted subsidiaries.

Another change in the economic environment that has encouraged LBOs is the 1981 tax law changes regarding accelerated depreciation. Over time accelerated depreciation will neither encourage nor discourage LBO transactions on net because recapture taxes balance the tax benefits. The initial acceleration in depreciation due to the tax law change encouraged higher leverage because it sheltered cash flow in the first few years.

However, as Ron Pearlman (Deputy Assistant Secretary for Tax Policy) testified before a subcommittee of the Senate Finance Committee on April 5, 1984, the recent flurry of merger activity is primarily not tax motivated. The tax incentives were in place long before the increased activity in 1984.

Is There Too Much Leverage?

It is difficult to determine how much leverage is too much largely because the answer depends on two future unknowns -- the levels of interest rates and business activity -- and is only obvious with 20/20 hindsight. Analysis is also complicated by the lack of research on the current level of leverage and how it is changing relative to the past. However, it is clear that at some level leverage becomes a significant problem, and that LBOs result in significantly more debt relative to equity than comparable industry averages. The leverage in LBOs varies widely with ratios ranging from 3:1 to 20:1 reported by the press. By comparison a 1983 study by the New York Stock Exchange indicated that the average

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

debt/equity ratio for all manufacturing firms was approximately 1/2 to 1 in early 1982, up from 1/3 to 1 in 1960.

Financial leverage magnifies business risks and rewards. The more leverage, the more likely a company could lose money or fail if business conditions deteriorate, and the higher the return and incentive to investors if business prospers. Leverage also magnifies the sensitivity of entities to the level of interest rates. Therefore, the more highly leveraged a company, the more likely it is to fail if interest rates rise or if there is a business slump. Too much leverage also distorts long-term investment incentives when the short-term necessity of paying down debt overrides investment goals. There is evidence that investment levels fall subsequent to LBO transactions.

Options

Options to handle the leverage issue include: do nothing and allow the market to correct any excesses, change the tax laws which encourage debt financing, and/or limit the amount of debt funding available through bank regulation. Since it is not easy to determine the correct amount of leverage, or whether there is a significant problem, SEC Chairman John Shad is probably correct in stating that it is as wrong to overreact as to ignore the potential problem. Furthermore, there are numerous advantages associated with LBOs which should not be discouraged.

Generally, the litany of advantages of mergers and acquisitions applies to LBOs. For example, they encourage capital to move to its most productive use. A couple of unique advantages are also cited: 1) Giving managers a larger equity incentive encourages them to work harder and increases productivity. As a result many companies have allegedly performed better after the LBO. 2) LBOs allow managers a respite from the vagaries of the capital markets and the stringencies and expense of SEC reporting to concentrate on long-term strategy instead of quarterly results. On the other hand, this argument cuts both ways because LBOs allow managers to escape the threat of disciplining takeovers. In any case, the advantages of LBOs argue for not tampering with the incentives for LBOs or the "do nothing" option.

The "Do Nothing" Option -- Over time the market generally corrects excesses and efficiently allocates resources. There is no need for the government to intervene

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

unless there is reason to believe that the market will not self-correct or the time needed to correct market excesses is intolerable. Adherents of the "do nothing" option explain that the government has no better information and less experience than the market players. The market players, especially the debt lenders, have years of experience with business cycles to help them assess the ability of businesses to sustain leverage. Moreover, they have the incentive to be prudent because they lose money if there is a default. On the other hand, debt lenders' record over the past two decades is not perfect (witness the REIT, energy and LDC loans.)

Another argument for the "do nothing" option is that the market has already begun to limit leverage available for LBOs, obviating a need for government intervention. Nearly 1/3 of the respondents to the Federal Reserve Board Senior Loan Officer Opinions Survey on Bank Lending Practices taken in mid-June reported that they have become more restrictive in lending for LBOs. According to George Roberts of Kohlberg, Kravis, Roberts & Co., a well-known LBO firm, debt-to-equity ratios have dropped to 3- or 5-to-1 from 8-to-1 three years ago for sound LBOs. Moreover, at least two brokerage houses have shelved plans for LBO funds indicating that the rise in equity funding is slowing down.

The "Change the Tax Incentives" Option -- There are some valid arguments that the market may not self-correct LBO debt levels, assuming, of course, that debt levels are too high. A Wall Street Journal editorial asserts that there is a tax law obstacle to self-correction - - i.e., the differing tax treatments of interest and dividends which encourage high debt levels. The editorial suggests that removal of double taxation on dividends will cure that problem. Another method to decrease the debt leverage incentive would be to change the definitions of debt and equity so that it would be harder to qualify for debt interest deductions. Changing these tax incentives could definitely reduce the level of leverage. However, such fundamental changes in tax policy must be carefully analyzed for their overall economic impact. Moreover, LBOs by themselves would hardly seem to warrant changing the tax law.

The "Regulate the Banks" Option -- Even if the market is self-correcting, it may take time for several reasons. First, lenders may have overestimated borrowers' ability to repay debt based on past experience because the current economic recovery is unique in that inflation has

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

remained low and will not bail out borrowers as it has for over two decades. Secondly, many of the participants in the LBO game are relatively inexperienced; they may have been too optimistic in their eagerness to obtain a piece of the action. Thirdly, as mentioned above, big banks are under pressure to increase net income now due to problem loans in other areas.

This leaves the third option of regulating the amount of leverage banks can supply in any transaction. Limiting the amount of debt banks may supply relative to equity in any transaction is one way to accomplish this. However, this approach could be overinclusive because it could cover highly-leveraged home mortgages, which few politicians would wish to touch. This approach is also underinclusive because it only limits bank debt lenders and ignores other debt lenders such as finance companies, pension funds and insurance companies.

In any case, bank regulatory agencies are monitoring the situation closely. On June 7, 1984 the Federal Reserve Board and the Comptroller of the Currency sent a memo to their examiners to ensure their awareness of the potential risks in leveraged buyouts and asking them to monitor LBO financings closely.

Do Managers Have an Inherent and Incurable Conflict of Interest?

One final issue peculiar to LBOs is the concern that by "going private" LBOs may unfairly benefit managers to the detriment of shareholders. Almost all LBOs retain existing managers and offer them equity incentives previously not available. Congressional Research Service estimates that between 1979 and May 1984 fifty percent of LBOs had management participation. In these cases there is an inherent conflict of interest. Managers have insider knowledge of operations and an incentive to set the LBO price as low as possible. Managers benefit more from a lower price because the resulting entity has more upside potential, of which managers have a higher ownership share.

Fortunately, there are usually market or legal checks on managers' behavior. If the price is too low in the case of a public company, it is not unusual for other entities to come in and bid up the price. Congressional Reseach Service estimates that between 1979 and May 1984, 18% of all potential LBOs involved increased bidding topped by another investor. In the case of a subsidiary, senior managers have access to much of the insider knowledge

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7

possessed by the middle managers taking the company private and the incentive to obtain outside opinions if needed. If senior managers are involved in the LBO as well, then the independent members of the board of directors often solicit an outside bid or hire an outside evaluator.

Finally, there is a body of state corporation law designed to protect minority shareholders when the LBO managers own a majority of the stock and to hold directors to a standard of reasonable business judgment.

Approved For Release 2008/11/05 : CIA-RDP86M00886R001900200006-7